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UNCLAS SECTION 01 OF 02 WELLINGTON 000465

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STATE FOR EAP/ANP-DRICCI AND EB
STATE PASS TO USTR FOR BWEISEL
COMMERCE FOR 4530/ITA/MAC/AP/OSAO/ABENAISSA
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E.O. 12958: N/A
TAGS: EINV ECON EFIN NZ
SUBJECT: NEW ZEALAND TAX CHANGES WOULD END PREFERENCE FOR INVESTMENT IN U.S., AMONG OTHERS

REF: WELLINGTON 396

¶1. (U) This is an action request; please see Paragraph 9.

¶2. (SBU) Summary: The New Zealand government has proposed changing the tax treatment of overseas stock-market investments in an effort to protect small investors. The proposal effectively would maintain a tax preference for portfolio investments in Australia, while removing tax benefits currently accorded portfolio investments in the United States and several other countries. End summary.

¶3. (U) New Zealanders' investments in any of eight countries on the "gray list" -- including the United States -- currently incur taxes only on dividends. Under legislation introduced May 17 in Parliament, the gray list would be abolished. Individuals who invest directly in share portfolios outside New Zealand and Australia would pay not only a tax on their dividends, but also a tax based on the change in value of their investments over the course of each financial year. It would be a partial tax on capital gains, even if the gains were unrealized. The tax would be applied on 85 percent of the paper gain in value, with the tax capped at 5 percent of the investment's value in any given year. (The carried-over tax would have to be paid if the shares were sold and the proceeds remitted back to New Zealand.) The rules would apply to all such overseas investments worth more than NZ $50,000 (US $31,200). Thus, most small investors would escape the partial capital-gains tax, but wealthy investors would not. Officials estimate that between 10,000 to 20,000 New Zealanders would pay the tax. (ABN AMRO Craigs contends that number is as many as 100,000 people.) Meanwhile, in general, individuals and companies that own 10 percent or more of a foreign company would continue to pay taxes only on dividends.

¶4. (U) Abolishing the gray list would mean that all offshore investments would be taxed the same, except for those in Australia. Holdings in Australia would be exempt from the partial capital-gains tax but still subject to a tax on dividends. Finance Minister Cullen and Revenue Minister Dunne gave several reasons for Australia's special treatment, including an eventual goal of establishing a single investment market of Australia and New Zealand and the fact that Australian companies -- like New Zealand companies -- tend to pay out a high proportion of their profits as dividends. Besides Australia, the seven other countries on the gray list are: Canada, Germany, Japan, Norway, Spain, the United States and the United Kingdom.

¶5. (U) The legislation also would make it more attractive to invest

in managed funds that trade in New Zealand and Australian shares and that meet certain criteria as vehicles for savings and investment. Managed funds no longer would be taxed on capital gains from investing in Australian and New Zealand shares. Instead, only the funds' earnings would be taxed, no longer at a flat 33 percent as they are now, but rather at the investor's marginal tax rate. Investors currently in the top income-tax bracket of 39 percent, however, still would have their earnings from managed funds taxed at 33 percent.

¶6. (U) The proposal is touted by its backers as a "fairer" investment tax regime. According to a statement issued April 11 by Ministers Cullen and Dunne: "As always there will be winners and losers. The losers in this case will tend to be sophisticated direct investors who have enjoyed considerable tax advantages under the old regime. ... The winners will be thousands of ordinary, hard working New Zealanders." The ministers estimated the reform would cost the government NZ $110 million a year in forgone tax revenue. The bill has been referred to the Finance and Expenditure Committee, which will receive public comments until July 7. If approved by Parliament, the changes would take effect in April 2007.

¶7. (U) Meanwhile, the government immediately introduced an amendment May 17 that would exclude overseas investments in certain types of companies from the new tax rules for five years, which would give the companies time to consider shifting their headquarters to New Zealand. The amendment was aimed primarily at benefiting Guinness Peat Group, a London-based investment company that has 28,000 New Zealand shareholders.

¶8. (U) The proposals on managed funds should encourage investment in the New Zealand stock market, while the changes for individual investors should encourage those looking for overseas investments to focus on Australia. The National Party condemned the tax proposal

as unfairly targeting New Zealanders who invest offshore. Business New Zealand, which represents business and employers' interests, criticized the changes for making it difficult for New Zealanders to diversify their portfolios.

¶9. (SBU) Action requested: New Zealand companies and individuals held NZ $15.7 billion (US $9.8 billion) in U.S. portfolio investments as of March 2005, or 44.7 percent of the stock of New Zealand's portfolio investment overseas. (Portfolio investment in Australia was only NZ $5.8 billion, or 16.5 percent of the total.) The Canadian consul in Auckland has asked post whether the U.S. government would take action on the tax proposal, noting the preference that it gives to investment domestically and in Australia. Post seeks Department guidance as to how to answer this inquiry. Post also recommends that, if U.S. agencies have questions or concerns about this proposed policy, it be added to the agenda for the U.S.-New Zealand Trade and Investment Framework Agreement discussions later this month.

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